



Corporate Guarantee

Financial Assurance Mechanisms

CERCLA Settlements and Orders

US EPA RECORDS CENTER REGION 5



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Office of Site Remediation Enforcement

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How it Works:

A guarantee is a contract by which one party (the "Guarantor") agrees to pay or perform the obligation of another party in the event that the latter party fails to pay or perform its principal obligation.

In the context of CERCLA financial assurance, a Guarantor guarantees the performance of (or payment for) the Work obligations of a settling defendant (a "Settling Defendant") under a CERCLA settlement document by providing EPA with a written agreement called a "Corporate Guarantee." A Settling Defendant securing a Corporate Guarantee still remains responsible for performing Work and paying Work costs as and when they arise. However, pursuant to the Corporate Guarantee, the Guarantor assures EPA that it will satisfy the Settling Defendant's Work obligations in the event the Settling Defendant is unable or unwilling to do so (including in the event of a "Work Takeover" under a CERCLA settlement document).

To be eligible to provide a Corporate Guarantee, a Guarantor must satisfy a number of conditions. First, the Guarantor must have some relationship to the Settling Defendant. That is, the Guarantor must either be a corporate parent of the Settling Defendant or it must be a company with which the Settling Defendant has a "substantial business relationship." Second, the Guarantor must pass one of two financial tests discussed below. If these conditions are satisfied, EPA may accept a Corporate Guarantee in satisfaction of a Settling Defendant's CERCLA financial assurance obligations. This approach may be appealing to a Settling Defendant because, if accepted, the Settling Defendant need not set aside funds now in the form of a trust fund, bond, letter of credit, insurance policy or other cash mechanism.

The two financial tests underpinning the Corporate Guarantee are the same as those underlying the "Financial Test" option of CERCLA financial assurance available to a Settling Defendant. These tests are designed to screen out companies with insufficient financial means to meet the relevant Work obligations. In addition, companies that pass either test are very unlikely to go bankrupt in the year following their annual certification of compliance. Thus, by passing the test annually, a Guarantor can demonstrate financial stability to EPA both as a general matter and, more specifically, as compared to the cost of the Work at issue.

The first test analyzes the general financial strength of the Guarantor by measuring several financial ratios. These ratios assess the Guarantor's liquidity, solvency, and leverage by measuring: (1) the Guarantor's total liabilities relative to its net worth; (2) the Guarantor's net income relative to its total liabilities; and (3) the Guarantor's current assets (e.g., cash, marketable securities, accounts receivable, etc.) relative to its current liabilities (e.g., accounts payable, short-term debt payable, accrued expenses, etc.).

The second test evaluates the general financial strength of the Guarantor by requiring a minimum bond rating as determined by national rating organizations. Under the test, a Guarantor must have a minimum bond rating of at least "BBB" as issued by Standard & Poor's or "Baa" as issued by Moody's.

In addition to the general financial measures described above, both tests require that a Guarantor pass several criteria that are keyed to the cost of the specific Work at issue. These criteria are that the Guarantor have: (1) a tangible net worth equal to at least six times the cost of the Work; (2) a tangible net worth equal to at least \$10 million; and (3) assets located in the U.S. with a value of at least six times the cost of the Work or amounting to at least 90% of the Guarantor's total assets. The first test adds one additional criterion, namely, that the Guarantor has net working capital equal to at least six times the cost of the Work.

What To Look For:

- ❑ A Guarantor must be (1) a direct or indirect parent company of a Settling Defendant; or (2) a company that has a "substantial business relationship" (as defined in 40 C.F.R. § 264.141(h)) with the Settling Defendant.
- ❑ A Guarantor providing a Corporate Guarantee to demonstrate CERCLA financial assurance must meet or exceed one of the two applicable financial tests. The specific test criteria are described in the RCRA financial responsibility regulations for TSD facility closure and post-closure at 40 C.F.R. §264.143(f)(1)(i) and (f)(1)(ii).
- ❑ The Guarantor's financial statements, which are used as the basis for determining whether the Guarantor passes either test, must be audited by an independent Certified Public Accountant ("CPA").

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- The Guarantor must submit the following three items on a yearly basis:
 - A letter to EPA signed by the Guarantor's Chief Financial Officer ("CFO"), detailing and certifying the Guarantor's satisfaction of either test. Examples of acceptable wording for the CFO letter are attached as Attachments A-1 and A-2 to this Tip Sheet;
 - A copy of the independent CPA's audit report of the Guarantor's financial statements for its most recent fiscal year (including a copy of the Guarantor's audited financial statements themselves); and
 - A special report from the Guarantor's CPA confirming that the data and conclusions in the CFO letter conform to the information contained in the Guarantor's audited financial statements. Examples of acceptable wording for the CPA report are attached as Attachments B-1 and B-2 to this Tip Sheet.
- When determining whether a Guarantor passes either test, EPA should take into consideration all of the environmental obligations that such Guarantor financially assures through its use of either the financial test (for its own obligations) or Corporate Guarantee(s) (for others' obligations).
- Examples of such obligations include, but are not limited to, those associated with CERCLA settlements; RCRA TSD facilities (closure, post-closure, and corrective action); municipal solid waste landfills; underground injection control facilities; underground storage tanks; and PCB storage facilities. Note that these obligations may arise in multiple EPA Regions and/or States.
- All of these liabilities should be (1) itemized in the CFO letter and (2) valued and aggregated for purposes of determining whether the Guarantor passes either of the financial tests.

What Happens If:

A Settling Defendant wants to use a Corporate Guarantee for purposes of demonstrating financial assurance?

- The Guarantor must forward the requisite documents as specified above to EPA for its review. As noted, the documents must address all settlements and facilities in the U.S. that the Guarantor financially assures through the financial test or Corporate Guarantee(s).
- An independent CPA must provide an audit report and issue an unqualified or "clean" opinion concerning the Guarantor's financial statements.
- The Guarantor must submit updated documents to EPA within 90 days of the close of each of the Guarantor's fiscal years.

The Guarantor changes its corporate status?

- If the Guarantor is merged or sold, the new or re-formed entity must meet the criteria of the financial test or negotiate alternative financial assurance with the Settling Defendant and EPA.
- The Guarantor must notify EPA within 10 days of its initiation of any bankruptcy proceedings.

A Settling Defendant seeks to use other mechanisms in combination with the Corporate Guarantee to satisfy its overall obligation?

- If the Corporate Guarantee is to be combined with other financial assurance mechanisms for purposes of the same settlement, Regions should ensure that the multiple mechanisms, in the aggregate, cover the Settling Defendant's entire financial assurance obligation.

The financial assurance amount required under the settlement document increases?

- If the required financial assurance amount increases, the Guarantor may demonstrate to EPA that it passes the financial test for the increased amount.
- If the Guarantor cannot pass the financial test for the increased amount, EPA should require the Settling Defendant to provide additional or alternative financial assurance in accordance with the terms of the CERCLA settlement document.

EPA believes the Guarantor may no longer meet the financial test requirements?

- EPA may request that the Guarantor submit reports detailing its financial condition at any time, that is, in addition to the requisite annual reports. Such additional reports may include quarterly SEC filings and/or financial statements, as well as other documentation.
- If, after reviewing these documents, EPA concludes that the Guarantor no longer meets the requirements of the financial test, the Settling Defendant must provide alternative financial assurance within 30 days of being notified to do so by EPA.

The Guarantor no longer meets the requirements of the financial test?

- If the Guarantor's fiscal year-end statements show that it no longer passes the financial test, or if the Guarantor at any time during its fiscal year becomes aware that it no longer passes the financial test, then the Guarantor must notify EPA of this fact, and the Settling Defendant must establish alternative financial assurance. The alternative financial assurance must be provided within 30 days after the end of the Settling Defendant's fiscal year or, as the case may be, within 30 days after the date the Settling Defendant becomes aware that the Guarantor no longer passes the financial test.

The Guarantor attempts to cancel the Corporate Guarantee?

- ❑ The Corporate Guarantee is irrevocable and cannot be revoked without EPA's prior written consent.
- ❑ However, the Corporate Guarantee may be terminated if (1) the Guarantor provides EPA with advance written notice of intended termination and (2) the Settling Defendant provides EPA with an acceptable substitute financial assurance mechanism (in accordance with the terms and conditions of the Consent Decree) prior to the termination date. In the absence of (2), the Corporate Guarantee cannot be terminated and shall remain in full force and effect.

The Settling Defendant fails to perform the Work?

- ❑ The Guarantor must perform (or pay for the performance of) the Work upon EPA's demand.

Why It Works:

- ❑ Only Guarantors with substantial positive net assets relative to the total CERCLA (and other) liabilities that they financially assure to the United States are likely to pass the standards of the financial test and thus be eligible to provide a Corporate Guarantee.
- ❑ Guarantors passing the financial test are unlikely to become bankrupt in the fiscal year following their annual demonstration of compliance.
- ❑ The Corporate Guarantee represents a flexible, low cost option for Settling Defendants to comply with their CERCLA financial assurance obligations. Unlike other mechanisms, the financial test does not require Settling Defendants to pay fees, premiums, or other costs to an unaffiliated third-party provider.

Challenges:

- ❑ The Corporate Guarantee can be a relatively high-risk mechanism for EPA and therefore requires thorough annual – or even more frequent – oversight.
- ❑ The financial tests underpinning the Corporate Guarantee presume that a Guarantor's recent past financial performance is a reasonable predictor of its future financial performance. However, the tests tend not to account for the sudden impact of external (or market) impacts on a Guarantor's financial condition.
- ❑ The financial ratios underlying the Corporate Guarantee are only as sound as the data used to compute them. If a Guarantor's accounting of its net assets or liabilities is inaccurate, or the quality of its assets is weak, the test ratio(s) may not represent the Guarantor's true financial condition.
- ❑ A Guarantor may have debts (or claims) against its assets that are not transparent on its financial statements. To the extent such claims are disclosed in the footnotes to its financial statements or elsewhere, EPA may want to adjust the ratio calculations accordingly.

Tips for Ensuring Success:

- ❑ The Corporate Guarantee requires that EPA be vigilant when reviewing a Guarantor's annual submissions. If,

for any reason, EPA believes that the Guarantor may no longer meet the financial test requirements, it should act without delay.

- ❑ The Corporate Guarantee requires a detailed review process; following each step is essential to calculating accurate ratios and determining overall compliance.
- ❑ In addition to analyzing Guarantors' annual submissions, Regions may decide to monitor the financial condition of certain Guarantors even throughout their fiscal years (particularly Guarantors who have financially assured high cost CERCLA settlements using the Corporate Guarantee and/or financial test).
- ❑ Such ongoing monitoring may consist of regular reviews of business press for adverse news about Guarantors with high-dollar financial assurance obligations secured through the financial test. EPA should take particular notice of any of the following events with respect to such Guarantors:
 - Significant decreases in net income or cash flow;
 - Decreases in bond ratings;
 - Sharp drops in stock prices;
 - De-listing from public exchanges;
 - Mergers, acquisitions, asset divestitures, debt restructurings, or other transactions affecting the Guarantor's corporate or financial structure;
 - Bankruptcy proceedings involving the Guarantor or any of its corporate affiliates; or
 - A "qualified" opinion from an independent CPA regarding the Guarantor's financial statements or the Guarantor's internal controls on its audit or finance functions.
- ❑ Proofread all documents to ensure that the language is comprehensive, precise, and generally consistent with the Attachments to this Tip Sheet.
- ❑ Take note of a Guarantor's fiscal year and be attentive to any changes to it. A company's fiscal year need not map to the calendar year. It may be that regular reporting deadlines occur at odd times.
- ❑ Ensure that all CERCLA, RCRA TSD, MSWLF, UST, UIC, TSCA, and other obligations that are financially assured by a Guarantor through its use of the financial test or its issuance of a guarantee are reported and accounted for in the analysis.

Contact:

- ❑ If you have any questions regarding the use of the Corporate Guarantee as CERCLA financial assurance, please contact Robert Polin of EPA's Office of Site Remediation Enforcement ("OSRE") at (202) 564-4292 or polin.robert@epa.gov, or Timothy DiCintio of OSRE at (202) 564-4790 or dicintio.timothy@epa.gov.
- ❑ This tip sheet can be found on the EPA intranet at: <http://intranet.epa.gov/oeca/osre/project/fa-mech.html>.]